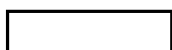


13 March 1979

NOTE FOR: Mr. Bowie

25X1A

FROM :



SUBJECT : Japan's Economy

1. Attached is a gist of a useful book on one aspect of Japan's economy.

2. I remain concerned that our focus is still too much on the difficulties faced by the government which seen in isolation are formidable. But compared to, say the United States, the Japanese government's ability to direct its economy is impressive. While it may take time to reach a consensus and to achieve results in Japan, the lags are nothing compared to the United States, witness the Administration's energy policy.

3. In light of this, while you are away I will continue to try to focus our consideration of this topic more on the opportunities available than on the difficulties to be encountered.

Attachment

JAPAN'S PUBLIC POLICY COMPANIES

By Chalmers Johnson

AEI-Hoover Policy Studies #24

American Enterprise Institute for Public Policy Research
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Every society presents one face to the world while maintaining its own, not necessarily secret, but certainly private way of getting its work done. The fascination of Japan is that the formal and overt aspects of its institutions are misleading as guides to how the society actually works. So be careful about concluding how Japan's economy works on the basis of superficial comparisons with others, but neither should one elevate Japan's uniqueness to the point of precluding serious comparisons. Many overt institutions are borrowed from abroad, but they work differently in Japan. For example, no Japanese entrepreneur is recorded as having claimed the right to run his enterprise as he saw fit without outside intervention.

There are seven major means of government guidance of the economy.

- Monetary & fiscal measures, e.g. long-term low-interest loans supplied to designated firms or industries
- Taxes intended to promote specific goals, e.g. pollution abatement
- Subsidies
- Direct allocation or rationing allows the government to fix what a factory may produce
- Licensing and approval authority typically used in Japan to foster rather than regulate an industry
- Direct investment in industry through special legal entities, the basic subject of the rest of this discussion.
- Administrative guidance to reconcile and achieve public and private objectives.

Although there were some antecedents public corporations have existed in Japan only since founding the Japan Iron & Steel Co. in '34 and reached full flower in the 50's and 60's. Japan uses public corporations in ways other open societies don't. We can learn from this, not necessarily to copy it, because only government in some form commands enough resources and can take the risks of major innovations needed to solve some problems, e.g. new energy supplies. But our approaches have been less successful than Japan's.

What the government does directly and what it does through public corporations isn't only a matter of policy; in part it is historic accident. Three examples of these interactions follow.

The history of Japan from the Meiji period is that of heavy state intervention shifting to withdrawal and then back again. State intervention in the Japanese economy from about 1930 to 1950 looked vaguely like that in the US, England, Germany, France and Italy. The current philosophy emerged in the 30's-40's from the convergence of:

- Struggles between industrial zaibatsu and their conservative bureaucratic allies, and the nationalistic bureaucrats and militarists who admired European fascism and Soviet planning.
- Experience of colonial development in East Asia, especially Manchuria.
- Desires to eliminate cutthroat competition and to build companies strong enough to compete with US and European companies, e.g. Japan Steel
- Pressures of war, e.g. 1938 National General Mobilization Law is the benchmark of government authority to investigate, demand reports and give administrative guidance.
- The US Occupation's imposition of concepts and tools which gave Japan's civilian bureaucrats the power to control industry that they had failed to gain under Tojo.

The forebearers of MITI are part of the story of the militarists attempts to control Japanese industry. On November 1, 1943 Tojo made his final effort to control the zaibatsu by creating the Ministry of Munitions with him as Minister. On August 26, 1945 Japan abolished the Ministry of Munitions and created the Ministry of Commerce and Industry (MCI) which was replaced by MITI in '49.

The Dodge Line, created in the Occupation in '49, established the principle of balanced or over-balanced budgets and had two unintended consequences. One was the commercialization of government services by means of public corporations to put new services on a "pay their own way" basis. So Japanese pay public corporations for many government services that are free elsewhere, but have a low tax burden. Second was to generate three separate national budgets, the general account budget (which until '65 the government always kept balanced), the special accounts oriented to named projects carefully segregated and audited, and the Fiscal Investment and Loan Plan (FILP). The FILP is known as the "2nd Budget"; 50% of the official national budget (both are submitted for Diet approval) and 6.3% of GNP, it finances public corporations and so is a major fiscal planning institution. The FILP is an investment plan for loans and expenditures from the government's various savings accounts and annuity programs combined with some direct appropriations and government borrowing.

As of 1975 various ministries controlled the following numbers of public corporations:

MITI	Agr & Forestry	Finance	Transportation	Construction	---	Total
27	19	16	14	10	---	112

The activities of these corporations involve the first and sixth categories of government control of the economy listed above.

It is important to recognize that "public corporation" in Japan covers a continuum of alternatives, not a set of legal pigeonholes, but for convenience, Japan's public corporations can be divided into six categories.

- I. Direct government enterprises: the postal service, forestry service, government printing (currency and stamps), the mint, industrial alcohol.
- II. Special legal entities, narrowly defined (tokushu hojin); about 112 ranging from big construction firms, through companies in agriculture, social welfare and energy development to the National Space Development Agency.
- III. Special legal entities, broadly defined: 3000-6000 depending on how you count including local governments, transportation, port and tourist facilities. They received about 20% of the FILP.
- IV. Auxiliary organs, associations, etc.: About 4400, all non-profit or non-commercial.
- V. National policy companies, narrowly defined.
- VI. National policy companies, broadly defined.

Now let us turn to discussion of some aspects of some of the categories of public corporations.

The government has tried to move some direct government enterprises (Type I) into the public corporate sector to improve labor relations (workers paid from the national treasury always see their employer differently than in a profit making organization) and fiscal accountability, but the Sohyo labor federation unions have blocked such efforts unless the 1948 law prohibiting strikes by direct government enterprise employees was repealed, something the government won't do.

Japan's public corporations are in fact extensions of the official bureaucracy. High ranking officials retire between 45-55 and obtain employment of four types (amakudari - "descent from heaven")

- Private profit making enterprise (there are some legal time restraints on this)
- A special legal entity (usually called yokosuberi, "sideslip," rather than amakudari)
- Politics, usually open only to those who served in choice posts advantageous to building political support

-Type IV auxiliary organs. All ministries maintain a few of these purely to pay salaries of retired bureaucrats in search of other jobs.

MITI dominates descents to big business. Finance tends to descend to public corporations. Agriculture leads in descents to politics, but finance does this too. Education and Foreign Affairs, for lack of connections, depend on their auxiliary organs.

Auxiliary Organs (Type IV) include Banana Importers Assoc., Patent Attorney's Assoc. and Japan Towel Inspection Foundation. Apart from amakudari such quasi-official institutes are the primary conduit for government-business community communications. Also such auxiliary organs (gaikaku dantai) are important for five reasons.

1. When a ministry can't convince the finance ministry to create a tokushu hojin, it may go ahead anyway with a private gaikaku dantai.
2. Later these may convert to tokushu hojin, e.g. Japan External Trade Organization (JETRO).
3. Many active bureaucrats serve short terms in these.
4. Some important entities exist as gaikaku dantai for political reasons though they're like tokushu hojin in form and function, e.g. Information Technology Promotion Agency.
5. Regular government agencies may be disguised as gaikaku dantai, e.g. the Japan-China Export-Import Union established by MITI in 1955 to carry on trade with the PRC while deflecting US criticism by saying it was a private organization.

Special Legal Entities, narrowly defined (Type II) spend 80% of the FILP. In '73, 303 of 384 directors of the 61 most influential tokushu hojin were retired officials. The tokushu hojin are corporate enterprises, each created by a special law as a result of political bargaining that leads the Ministry of Finance to pay for it and the Administrative Agency of the Prime Minister's office to designate it, and may take many corporate forms. The 112 can be classified in many ways, in terms of their

- official typology
 - basic functions: money lending, money spending, price stabilization, etc.
 - sectoral interests: industrial development, transportation, social welfare, energy
 - controlling ministries
 - degree of independence from the Diet
 - access to FILP funds
- and also perhaps in terms of their
- capacity to absorb retired bureaucrats

- controlling ministries' strategies in governmental bureaucratic competition for "turf"
- functions in the central ministries' schemes to expand control over local governments.

Official typology serves in part to obfuscate, but is useful. These include

- 3 Kosha: Japan National Railways, Japan Monopoly, and Nippon Telephone & Telegraph
- 15 Kodan: These are the heart of the public enterprise sector. They include Japan Housing Corp., Internal Passenger Ship Corp., port development authorities, etc.
- 20 Jigyodan: Smaller Kodan, e.g. FOUMIN's International Cooperation Agency, Japan Nuclear Ship Development Agency and MITI's Small Business Promotion Corp.
- 10 Koko: Central bureaucracy's operating arms in public finance. The government supplies all their capital. They are to supplement the general banking system by financing clients that can't get credit, e.g. risky ventures, but that the government wants to have financed. The Diet approves their budgets and annual plans and so they serve to guide the economy by indicative loans. The Housing Loan Corp. and Okinawa Development Finance Corp. are examples.
- 2 Special Banks (tokushu ginko) are Japan Export Bank & Japan Development Bank formally controlled by FM, but strongly influenced by MITI. Their loans are the chief links between government and type V and VI companies. The real importance of Special Bank's loans in the 50's-60's was not their size but their role as MITI's seal of approval, "If the Kaigin (Development Bank) has invested, my city bank will lend me more."

Like those above, other special legal entities are the products of history, or the government's response to diverse problems and opportunities since World War II.

National Policy Companies, narrowly defined, (Type V) differ from special legal entities primarily because they aren't based on special laws. They originate in government initiatives and, unlike VI, are government financed. Because definitions are subtle (i.e. V or VI vs. general private enterprise is largely miuchi ishiki, "consciousness of kinship," with government) one can't count either category. They (V) are sometimes called sokusei saibai ("raising out-of-season crops using artificial heat") because they are in sectors that the government wants developed, but are too risky or unprofitable for private capital, e.g. Japan Electronic Computer Co. or Japan Synthetic Rubber Co.

National Policy Companies, broadly defined (Type VI), are in-between firms distinguished mostly by high correlations between their officers and government, and histories of government interventions on their behalf. They're comparable to US defense industries. The best example is the New Japan Steel Company, Japan's largest enterprise and the world's largest steel producer.